Due service of the within Brief is hereby acknowledged this.....day of December, A. D. 1932.

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Attorneys for Petitioner.

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IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1932

No. 541.

David Burnet, Commissioner of Internal Revenue,
Petitioner,

vs.

A. T. Jergins Trust,
Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, NINTH CIRCUIT.

BRIEF FOR RESPONDENT.

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ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, NINTH CIRCUIT.

BRIEF FOR RESPONDENT.

I.

Opinions Below.

The opinion of the United States Board of Tax Appeals [R. 115-124] is reported in 22 B. T. A. 551.* The opinion of the United States Circuit Court of Appeals, Ninth Circuit [R. 182-187], is reported in 61 Fed (2d) 92.

* Taxpayer sought review of the Board's decision in holding that its income was not immune from taxation while the Commissioner sought review of the Board's decision holding that Taxpayer was entitled to depreciation on its intangible costs of developing oil property. Both cases, however, were heard together by the Circuit Court of Appeals and the Circuit Court of Appeals having held that the income was exempt, that, therefore, the appeal raised by the Commissioner became academic.

II.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered September 8, 1932. [R. 187.] The petition for writ of certiorari was filed December 8, 1932. The jurisdiction of this court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

III.

Questions Presented.

1. Whether, under the Federal Constitution and the Constitution of the state of California, the income derived by Taxpayer from the development and operation of land belonging to the city of Long Beach pursuant to a lease for a definite period is immune from federal taxation.

2. Are expenditures for wages, fuel, repairs, hauling, et cetera, in connection with development and drilling of oil wells, capital expenditures subject to depreciation?

Question No. 2 becomes academic if Question No. 1 is answered in Taxpayer's favor.

IV.

Statutes and Constitutions Involved.

These are set forth in the appendix, *infra*, page 41.

V.
STATEMENT OF THE CASE.

(1)
History of the Case.

This controversy originated by a deficiency letter issued by the Commissioner of Internal Revenue (referred to herein as the Commissioner) dated May 28, 1927 [R. 60-71], proposing a deficiency in income taxes against Respondent (hereinafter sometimes referred to as Taxpayer) for the years 1922, 1923 and 1924 amounting to the sum of $65,953.88. The Respondent appealed to the United States Board of Tax Appeals, which appeal contained two issues, to-wit:

> (1) Whether the income derived by Taxpayer was immune from taxation, and
>
> (2) Whether Taxpayer was entitled to depreciation or depletion on intangible development costs.

On the 5th day of March, 1931, the United States Board of Tax Appeals rendered its opinion where it, on authority of its own decision in *Coronado Oil & Gas Company v. Commissioner*, 14 B. T. A. 1214, held that the income derived by Taxpayer was not immune from taxation and that Taxpayer was entitled to depreciation rather than depletion allowances on the intangible development costs. Taxpayer appealed to the Circuit Court of Appeals from the Board's decision holding that Taxpayer's income was not immune from taxation and the Commissioner appealed from the Board's decision holding that Taxpayer was entitled to depreciation rather than depletion deductions on intangible development costs. The

decision of the Board of Tax Appeals in the case of *Coronado Oil & Gas Company v. Commissioner,* 14 B. T. A. 1214, was reversed by this Court on the 11th day of April, 1932, and the Circuit Court of Appeals on the 8th day of September, 1932, decided that the income of Taxpayer was exempt from taxation. Having so held, the Circuit Court did not pass upon the question raised by the Commissioner in his appeal.

(2)

Facts Involved.

The Findings of Fact made by the United States Board of Tax Appeals [R. 98-115] established, among others, the following facts:

For some years prior to 1911 the city of Long Beach had obtained its water supply from independent water companies which in turn obtained their water from subterranean sources through artesian wells on land located approximately three miles north of the city of Long Beach. The water mains of these companies were made of such material that water escaped therefrom and caused mudholes in the streets. When it was necessary to shut the water off from the mains outside water would seep back into them and contaminate the water which thereafter came through them for the use of the city and its citizens. [R. 98.] The escaping water became stagnant and created unsanitary conditions. The mains could not resist sufficient pressure to enable the fire department to fight fires. To correct these conditions the city, in 1911, by public vote, authorized a bond issue for the purpose of acquiring these water lands and water systems. With

the money thus obtained the city, in 1911, acquired about 600 acres of this land which has ever since been used by the city as a source of water supply. [R. 99.]

The Respondent was created in April, 1922, by virtue of a declaration of trust executed under and pursuant to the laws of the state of California, for the purpose of entering into an oil and gas lease with the city of Long Beach. On April 11, 1922, oil having been discovered in the vicinity of Long Beach, the city of Long Beach, as lessor, and Taxpayer, as lessee, entered into an oil and gas lease on approximately 140 acres of its water lands. The lease, among other things, provided [R. 100-108]:

(1) That Taxpayer would receive 60% of the proceeds derived from the oil and gas and the city would receive the balance or 40%;

(2) That Taxpayer was to pay all taxes on properties placed by it on the premises and 60% of all taxes levied by the State or Federal Government;

(3) That no structure should be erected within 150 feet of any reservoir;

(4) That no work should be done on west half farm lot 59 without the consent of the City Manager;

(5) That the lessee should operate so as to interfere as little as possible with reserved uses of lessor;

(6) That the lessee should protect all waterworks of lessor against any and all damage.

For the protection of its rights under the lease, the city during the years in question, maintained on the property a laboratory for the purpose of testing all the oil and gas produced; the city employed an oil engineer whose duty it was to see that Taxpayer performed and did not vio-

late its contractual duties and to see that the city obtained the maximum amount to which it was entitled under the lease. [R. 109.] The oil and gas recovered from said premises have been sold under a joint contract of the city and Taxpayer as provided in the lease. Tests were made of the runs of oil. Conferences between Taxpayer's representatives and the city authorities have been generally held whenever the location of a new well was to be determined.

In 1922 all of Taxpayer's gross income was derived from oil and gas produced under the lease. In 1923 $985,790.34 was so derived, and in 1924 $1,935,376.82. [R. 109-110.] The Board of Tax Appeals held that the United States could tax that income, and sustained the Commissioner's determination to that extent. [R. 118.]

There was also submitted to the Board the question whether certain capitalized sums expended by the Taxpayer for drilling costs and development expense in connection with oil wells were returnable to Taxpayer through a depletion or a depreciation allowance. [R. 113-115.] The Commissioner had treated such sums as subject only to a depletion allowance, but the Board held that they were subject to depreciation allowance. [R. 120-123.]

The Taxpayer appealed from the portion of the Board's decision holding that its income derived from the oil lease on city lands was taxable, and the Commissioner appealed from the portion of the Board's decision allowing deduction of capitalized costs as depreciation. The Circuit Court of Appeals for the Ninth Circuit held that the tax proposed by the Commissioner could not constitutionally be imposed upon the income derived by the Taxpayer

from the sale of oil taken from the land leased by the city, and concluded that the assessment of the Commissioner should be set aside. Accordingly, the Court did not pass upon the question presented by the Commissioner's appeal as that question then became academic.

As to Deductions for Depreciation.

During 1922 the respondent expended $59,376.86 for physical equipment, and $102,508.85 for wages, fuel, repairs, hauling, et cetera, in connection with development and drilling. [R. 113.] The full amount of these expenses, $161,885.81, was capitalized in the determination of the deficiency for the year 1922. [R. 114.]

During the year 1923 Respondent expended $260,313.62 for physical equipment, and $431,393.11 for wages, fuel, repairs, hauling, et cetera, in connection with development and drilling. The full amount, $691,706.73, was capitalized in the determination of the deficiency for the year 1923. [R. 114.]

During the year 1924 the Respondent expended $303,244.69 for physical equipment, and $452,226.75 for fuel, repairs, hauling, et cetera, in connection with development and drilling. The full amount, $755,471.44, was capitalized in the determination of the deficiency for 1924 [R. 114.]

The Petitioner allowed depreciation only on the amounts expended for physical equipment, and added the drilling expenses to sums recoverable through depletion. [R. 114.] He computed Respondent's depreciation allowance for 1924 based upon cost of leaseholds and development cost plus discovery value at the amount of $1,228,864.99, and allowed a deduction of $771,982.99. [R. 114-115.]

VI.

Summary of Argument.

It is well settled that under the Federal Constitution neither the Federal Government nor the states may tax the property of the other. This Court in the case of *Lee v. Osceola Improvement District*, 268 U. S. 643, at page 645, stated:

> "It was settled many years ago that the property of the United States is exempt by the Constitution from taxation under the authority of a state so long as title remains in the United States."

The income here involved is the income from city owned land.

It is equally well settled that if the land cannot be taxed then the revenue derived therefrom cannot be taxed. It is likewise well settled that neither the Federal Government nor the state government may tax the instrumentalities of the other.

Pollock v. Farmers Loan and Trust Company, 157 U. S. 429, 158 U. S. 601;

Indian Territory Illuminating Oil Co. v. Oklahoma, 240 U. S. 522;

Union Pacific Railroad Company v. Peniston, 18 Wall. 5;

United States v. Baltimore & Ohio Railroad Company, 17 Wall. 322, 21 L. Ed. 597;

Collector v. Day, 11 Wall. 113;

McCulloch v. Maryland, 4 Wheat. 316;

Gillespie v. State of Oklahoma, 257 U. S. 501;

Burnet v. Coronado Oil & Gas Co., 285 U. S. 393, 76 L. Ed. 815.

The principle that the Federal Government may not tax the property of a state or the income therefrom applies whether the land is held by the sovereign in a proprietary or a so-called governmental capacity.

Woodruff v. North Bloomfield Gravel Co., 18 Fed. 754-772;

Irwin v. Wright, 258 U. S. 219;

Van Brocklin v. Tenn., 117 U. S. 151;

Wisconsin Central Railroad Co. v. Price County, 133 U. S. 496;

Lee v. Osceola Improvement District, 268 U. S. 643.

The land owned and leased by the city of Long Beach to Taxpayer was part of a tract acquired and used by the city of Long Beach in its governmental capacity inasmuch as it was purchased in 1911 by the city of Long Beach in order to:

(1) Improve its streets;

(2) Eliminate unsanitary conditions;

(3) Protect the health of the community;

(4) Provide adequate water and pressure for fighting fires, and

(5) To assure a clean and wholesome supply of water for its inhabitants.

The same considerations that invalidate a tax on the city's lease invalidate a tax upon the profits derived by the A. T. Jergins Trust from the lease; that the city's profit from the lease will be diminished to some extent by the requirement that the lessee pay a tax upon its income derived from the city's property is as clear in the case at

bar as in those cases wherein the right of the Federal or state government to tax proceeds from publicly owned lands has been denied. A tax on the instrumentality of the city of Long Beach is "derogatory to the latter's dignity, subversive of its powers and repugnant to its paramount authority."

VII.

ARGUMENT.

The Decision of the Ninth Circuit Court of Appeals in This Case Is Merely the Affirmation of Constitutional Principles Recognized by This Honorable Court for More Than a Century.

The case at bar arises because of two sovereigns established in the same territory, the state and the United States (the city of Long Beach is merely exercising delegated state sovereign powers). The taxing power of both on subjects which they may tax is unlimited. If one may tax the other at all, there is no limit as to how much it may so tax it. As has been truly stated, if one may tax the other "lightly" it may do so "heavily, if justly, oppressively," or as has also been stated, if one may tax the other at all it may, by such power, destroy the other altogether. The power once admitted is unlimited and through it the sovereignty of each of the governments might be partially or totally destroyed by the other.

The foundation of the case is, therefore, based upon the rule which arises by reason of the separate governments and which is implied in the Constitution, that neither the states nor the United States may tax each other. It requires no argument to establish this rule of

law at this late date. It has been decided so many times that the mere statement of it brings to mind a long list of celebrated cases. (*McCullock v. Maryland*, 4 Wheat 316; *Abelman v. Booth*, 21 Howd. 506; *Collector v. Day*, 11 Wall. 113; *U. P. Ry. Co. v. Peniston*, 18 Wall. 5; *U. S. v. B. & O. Ry. Co.*, 17 Wall. 322; *Pollock v. Farmers Loan and Trust Co.*, 157 U. S. 429; *Indian Oil Co. v. Oklahoma*, 240 U. S. 522; *Gillespie v. Oklahoma*, 257 U. S. 501; *Burnet v. Coronado Oil & Gas Co.*, 285 U. S. 393; 76 L. Ed. 815), and many others. The only difficuties which have arisen in recent times in connection with the rule have been the effort of too diligent tax gatherers, to use their own phrasing, "to whittle the rule down until it is of no more effect". There have been vicarious efforts to tax indirectly what could not be taxed directly and these efforts have uniformly been repulsed by the courts who have restated the rule and maintained its effectiveness.

These efforts have been made by seeking to tax interest on state and municipal bonds, the income from city investments, income from oil leases where the ground upon which the leases were made could not be taxed, and in other ways which would amount to burdening the United States, States, and Municipal Governments indirectly by interfering with and making it difficult and expensive for such governments to perform their ordinary obligations as sovereigns to the citizens which compose them. In every case where the attempt has been made it has been held beyond the taxing power, and an unwarranted interference with the sovereign power. These efforts led Justice Holmes to say "the rule as to instru-

mentalities of the United States * * * is absolute" (*Gillespie v. Oklahoma*, 257 U. S. 501, at page 505). The argument has been made in every case which has come before the courts that where the income belongs to a private person or corporation after it has been segregated from the nontaxable property, it is too remote to fall within the rule stated, and the answer has been over and over again that if the source cannot be taxed the income therefrom shares the same immunity.

In the famous case of *Pollock v. Farmers Loan and Trust Company*, 157 U. S. 429, on rehearing, 158 U. S. 601, at page 618, the Supreme Court said:

> "* * * As to the income from municipal bonds, they could not be taxed because of want of power to tax the source, * * *."

Further on at page 630 the Supreme Court made the following comment:

> "* * * and it follows that, if the revenue derived from municipal bonds cannot be taxed because the source cannot be, the same rule applies to revenue from any other source not subject to the tax; * * *."

The same principle is laid down as absolute in the following cases:

> *Northwestern Mutual Life Insurance Co. v. Wisconsin*, 275 U. S. 136;
>
> *Gillespie v. State of Oklahoma*, 257 U. S. 501.

In the case of *Gillespie v. State of Oklahoma*, 257 U. S. 501, the Court spoke as follows:

> "The rule as to instrumentalities of the United States, * * * is absolute in form * * *. 'A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them.' 240 U. S. 530. The step from this to the invalidity of the tax upon income from the leases is not long.
>
> "In cases where the principal is absolutely immune from interference, an inquiry is allowed into the sources from which net income is derived, and if a part of it comes from such a source, the tax is *pro tanto* void."

The mandate of the Supreme Court expressed in the foregoing could not be more definite:

> "The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases."

In the case of *Northwestern Mutual Life Insurance Company v. Wisconsin*, 275 U. S. 136, the Supreme Court said at page 140:

> "Certainly, since Gillespie v. Oklahoma, 257 U. S. 501, 505, it has been the settled doctrine here that where the principal is absolutely immune, no valid tax can be laid upon income arising therefrom."

The source of the revenue in this case was the land belonging to the city of Long Beach. Even disregarding for a moment the circumstances under which and purposes for which the land in question was acquired and

used by the city, could the Federal Government lawfully and constitutionally impose a tax upon that land?

In the case of *Pollock v. Farmers Loan and Trust Company*, 157 U. S. 429, at page 584, we find the following language which is at once expressive of the reasoning and the decision of the Court in that case:

> "As the States cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a State.
>
> "A municipal corporation is the representative of the State and one of the instrumentalities of the state government. It was long ago determined that the property and revenues of municipal corporations are not subjects of Federal taxation. Collector v. Day, 11 Wall. 113, 124; United States v. Railroad Company, 17 Wall. 322, 332. In Collector v. Day, it was adjudged that Congress had no power, even by an act taxing all incomes, to levy a tax upon the salaries of judicial officers of a State, for reasons similar to those on which it had been held in Dobbins v. Commissioners, 16 Pet. 435, that a State could not tax the salaries of officers of the United States. Mr. Justice Nelson, in delivering judgment, said: 'The general government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its appropriate sphere is supreme; but the States within the limits of their powers not granted, or, in the language of the tenth amendment, "reserved", are as independent

of the general government as that government within its sphere is independent of the States.'

"This is quoted in Van Brocklin v. Tenn., 117 U. S. 151, 178, and the opinion continues: 'Applying the same principles, this court, in United States v. Railroad Company, 17 Wall. 322, held that a municipal corporation within a State could not be taxed by the United States on the dividends or interest of stock or bonds held by it in a railroad or canal company, because the municipal corporation was a representative of the State, created by the State to exercise a limited portion of its powers of government, and therefore its revenues, like those of the State itself, were not taxable by the United States. *The revenues thus adjudged to be exempt from Federal taxation were not themselves appropriated to any specific public use, nor derived from property held by the State or by the municipal corporation for any specific public use, but were part of the general income of that corporation, held for the public use in no other sense than all property and income, belonging to it in its municipal character, must be so held.* The reasons for exempting all the property and income of a State, or of a municipal corporation, which is a political division of the State, from Federal taxation, equally require the exemption of all the property and income of the national government from state taxation.'" (Italics ours.)

Incidentally, the language italicized by us above ought to be a sufficient answer to the objection offered by the Commissioner to the effect that the income here involved is not dedicated to any particular public use.

There have been several attempts on the part of the states to tax lands belonging to the United States. (*Van*

Brocklin v. Tenn., 117 U. S. 151; *Wisconsin Central Railroad Company v. Price County*, 133 U. S. 496; *Lee v. Osceola Improvement District*, 268 U. S. 643.) Each and all of these efforts have failed.

The courts have uniformly held that the states and their political subdivisions have no power or authority to impose a tax upon lands held in the name of the United States, and this is true even though such lands are held by the United States in its proprietary rather than its sovereign capacity. (*Woodruff v. North Bloomfield Gravel Co.*, 18 Fed. 754.) While there have been numerous attempts on the part of the states and their political subdivisions to tax the lands of the Federal Government, there has not been so far as our search reveals even an attempt on the part of the Federal Government to tax any lands belonging to a state or one of its political subdivisions. The very reasons that forbid the one forbid the other. They are alike repugnant to the established conception of the dual sovereignty of the several states and of the United States. Chief Justice Taft summarized the rule in *Irwin v. Wright*, 258 U. S. 219, where he said at page 228:

> "The rule established by the decisions of this court is that, by virtue of the sovereignty and constitutional power of Congress to dispose of and make all needful rules and regulations respecting the territory or other property belonging to the United States, no state can tax the property of the United States within its limits."

Does not a state have the power "to dispose of and make all needful rules and regulations respecting the territory or other property belonging to the" state or of one of its

political subdivisions operating through a charter granted by the state? Such power is inherent to sovereignity. Such power was never relinquished by the states to the Federal Government. The Federal Government recognized this when in its Act of August 5, 1861, levying a direct tax apportioned in conformity with the Constitution it provided in section 13 of the Act as follows:

> "Provided however that all property of whatever kind, coming within any of the foregoing description, and belonging to the United States or any state, either permanently or specially exempted from taxation by the laws of the state wherein same may be situated at the time of the passage of this Act * * * shall be exempted from the aforesaid enumeration and valuation and from the direct tax aforesaid."

Section 1 of article XIII of the Constitution of the state of California provides that property belonging to the "United States, this state, or to any county, city and county, or municipal corporation within this state shall be exempt from taxation". Section 12 of article XIX of the Constitution of the state of California provides as follows:

> "The Legislature shall have no power to impose taxes upon counties, states, or other public or municipal corporations, or upon the inhabitants or property thereof for county, city, town or other municipal purposes. * * *."

There have been a large number of acts levying direct taxes upon land in the United States enacted by Congress

during the history of our country, and so far as we are aware no attempt has ever been made to levy a tax upon land belonging to a municipality. The acts have always recognized the constitutional limitation by expressly exempting such property from the provisions of the acts.

THE DECISION OF THE COURT BELOW DOES NOT INVOLVE AN EXTENSION OF THE IMMUNITY OF STATE INSTRUMENTALITIES FROM FEDERAL TAXATION.

The Commissioner, in his petition, states:

> "The decision of the court below involves a radical extension of the immunity of State instrumentalities from Federal taxation. Such immunity is extended in this case to the lessee of oil lands owned by a municipality which were not devoted to a governmental purpose, without proof that the royalties payable to the city under the provisions of the lease were to be devoted to any governmental purpose."

The lower court's decision, as we view it, does not in any manner involve an extension of the doctrine of immunity of State instrumentalities. It holds that land belonging to a municipality is immune, and that a tax upon the income of the land, being a tax upon the land itself, bears the same immunity. The court also holds that the ownership of the land is closely related to governmental activities.

The statement of the Commissioner, it is respectfully submitted, fails to recognize the significance of the Findings of Fact of the Board of Tax Appeals, which show distinctly that the city's purpose in acquiring the land was to clean up the unsanitary conditions then existing in its water supply, to improve the streets and to provide ade-

quate pressure for fighting fires. It was the lack of sanitary conditions, the lack of adequate pressure for fire fighting purposes and the lack of wholesome water for its inhabitants that prompted the city to issue bonds for the purpose of acquiring the water lands. The record discloses that the lands have ever since been used for the purposes for which they were acquired. In addition thereto, the land has been devoted to other uses which did not interfere with the city's water systems.

The city of Long Beach was created for the purpose of protecting the life, liberty and property of its citizens and promoting their general welfare. The protection of life includes necessarily the protection of health which can be attained only by eliminating unsanitary conditions and the maintenance of clean environment and safe highways for travel. It also includes protection of life and property by guarding against destructive fires which can only be accomplished by having proper fire fighting apparatus supported by an adequate and reliable water supply.

This Honorable Court has held that:

> "No higher police duty can rest upon municipal authority than that of furnishing an ample supply of pure and wholesome water for public and domestic uses. The preservation of the health of the community is best obtained by the discharge of this duty, to say nothing of the preservation of property from fire, so constant an attendant upon crowded conditions of municipal life."
>
> *City of Columbus v. Mercantile Trust & Deposit Company of Baltimore*, 218 U. S. 645, 54 L. ed. 1193.

It is the established law in the state of California that the activity of the city in the protection against or extinguishment of fires and the maintenance of public streets and roads are governmental functions.

Denning v. State, 123 Cal. 316;

Davoust v. City of Alameda, 149 Cal. 69.

See also:

Chicago, B. & Q. Railroad Co. v. Illinois ex rel. Grimwood, 200 U. S. 561, 50 L. ed. 596.

The record conclusively establishes the fact that the city of Long Beach acquired and held its lands for at least three governmental purposes, to-wit: protection against fire, protection of health and maintenance of streets. The Commissioner, in his brief before the Circuit Court of Appeals (page 27), specifically admitted that fire protection is a governmental function. The "furnishing of an ample supply of pure and wholesome water for public and domestic purposes" is also a governmental function, but even conceding that the furnishing of pure and wholesome water was in the nature of a so-called proprietary function, nevertheless, that would not be sufficient reason to deny to Taxpayer the application of the principles herein contended for.

The argument now advanced by the Commissioner was advanced by the state of Maryland in the famous case of *McCulloch v. Maryland*, 4 Wheat. 316. Mr. Hopkinson, representing the state of Maryland, argued that it was no essential governmental function for the United States to charter and regulate a national bank, and particularly was it outside the constitutional powers of the Federal

Government to do so since the branch of the national bank was actually engaged in business and competing with local banks. Mr. Webster, who represented the Federal Government, stated in his brief, page 330:

> "* * * A bank may not be, and is not, absolutely essential to the existence and preservation of the government. But it is essential to the existence and preservation of the government that Congress should be able to exercise its constitutional powers at its own discretion, without being subject to the control of state legislation. The question is not whether a bank be necessary, or useful, but whether Congress may not constitutionally judge of that necessity or utility; and whether, having so judged and decided, and having adopted measures to carry its decision into effect, the state governments may interfere with that decision, and defeat the operation of its measures. * * *."

The argument of Mr. Webster was adopted by Chief Justice Marshall wherein he stated at pages 409 and 410:

> "The government which has a right to do an act, and has imposed on it the duty of performing that act, must, according to the dictates of reason, be allowed to select the means; and those who contend that it may not select any appropriate means, that one particular mode of effecting the object is excepted, take upon themselves the burden of establishing that exception."

At page 411:

> "* * * No city was ever built with the sole object of being incorporated, but is incorporated as affording the best means of being well governed. * * *."

At pages 415 and 416:

> "* * * To have prescribed the means by which government should, in all future time, execute its powers, would have been to change, entirely, the character of the instrument, and give it the properties of a legal code. It would have been an unwise attempt to provide, by immutable rules, for exigencies which, if foreseen at all, must have been seen dimly, and which can be best provided for as they occur. To have declared that the best means shall not be used, but those alone without which the power given would be nugatory, would have been to deprive the legislature of the capacity to avail itself of experience, to exercise its reason, and to accomodate its legislation to circumstances. If we apply this principle of construction to any of the powers of the government, we shall find it so pernicious in its operation that we shall be compelled to discard it. * * *."

At page 421:

> "* * * Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consist with the letter and spirit of the constitution, are constitutional."

In view of the foregoing, it is respectfully submitted, that the record disproves the statement in the Commissioner's brief, to-wit: that the "lands were not devoted to a governmental purpose". The Commissioner should, as he did before the Appellate Court, recognize at least the element of the exercise of a governmental function in the acquisition of the lands. It is believed that the record conclusively demonstrates that the lands were acquired and

were used for governmental purposes, but even assuming that there was an element of a proprietary function still that would not be sufficient reason for overruling the lower court's opinion. The question the Commissioner desires this Court to pass on was presented to this Honorable Court more than one hundred years ago. The branch bank of the United States (referred to in the case of *McCulloch v. State of Maryland,* 4 Wheat. 316) operating at Baltimore was not only a Federal depositary created under the National Banking Act, but was also engaged in a general banking business in competition with local banks. In commenting on the famous case of *McCulloch v. State of Maryland,* this Honorable Court in *Osborn v. United States,* 9 Wheaton 738, 6 L. ed. 204, stated at page 860:

> "* * * The whole opinion of the court, in the case of McCulloch v. The State of Maryland, is founded on, and sustained by, the idea that the bank is an instrument which is 'necessary and proper for carrying into effect the powers vested in the government of the United States.' It is not an instrument which the government found ready-made, and has supposed to be adapted to its purposes; but one which was created in the form in which it now appears, for national purposes only. It is, undoubtedly, capable of transacting private as well as public business. While it is the great instrument by which the fiscal operations of the government are effected, it is also trading with individuals for its own advantage. The appellants endeavor to distinguish between this trade and its agency for the public, between its banking operations and those qualities which it possesses in common with every corporation, such as individuality, immortality, etc. While they seem to admit the right

> to preserve this corporate existence, they deny the right to protect it in its trade and business."

And at page 867:

> "If the trade of the bank be essential to its character as a machine for the fiscal operations of the government, that trade must be as exempt from state control as the actual conveyance of the public money. Indeed, a tax bears upon the whole machine; as well upon the faculty of collecting and transmitting the money of the nation, as on that of discounting the notes of individuals. No distinction is taken between them."

The Federal Government had only the implied right to create a bank while in the case at bar the city of Long Beach had specific authority in its charter and in the Constitution of the state to own and use the land. The state Constitution forbids the taxing of the land. If the contention now made by the Commissioner were sound, we would not have had the decision in the famous McCulloch case. This Honorable Court has repeatedly held that the purchase by a city of securities of a private corporation was an exercise of a governmental function. (*United States v. Baltimore & Ohio Railroad Company*, 17 Wall. 322, 21 L. Ed. 597.)

The city's ownership of bonds is no more sacred and no more a sovereign right than its ownership of land, even though that land be revenue-producing. A municipal bond is property of the city; likewise, the land in this case is property of the city. Neither logic nor common sense could make a distinction between them insofar as the sovereign right is concerned; "* * * as to the income

from municipal bonds, that could not be taxed because of want of power to tax the source;" *as to the income from the city's land, that could not be taxed because of want of power to tax the source.*

> "* * * And it follows, that if the revenue derived from municipal bonds cannot be taxed because the source cannot be, the same rule applies to revenue *from any other source not subject to tax.*" (Italics ours.)

The Commissioner's contention has for its background the existence of numerous decisions distinguishing between strictly "governmental functions" and "proprietary functions" of political subdivisions. The distinction sometimes referred to between the so-called "governmental" and "proprietary" functions of a municipality is a creature of the courts, conceived by the judges to promote justice to injured litigants. The decline of the theory that "the King can do no wrong" and the advent of the complex municipal instrumentalities capable of much good and much harm, assisted in its development. This doctrine, created to give justice to the injured individuals, is merely a procedural rule and has been confined almost exclusively to tort cases. However, we seriously assert that in the final analysis the distinction between a strictly governmental function and the so-called proprietary function cannot be used as the criterion of interference by taxation by the Federal Government of the functions of the states.

This Honorable Court has repeatedly held that "those agencies through which either government immediately and directly exercises its sovereign powers are immune from the taxing power of the other." (*Metcalf & Eddy*

v. Mitchell, 269 U. S. 514, 70 L. Ed. 384.) The Commissioner places great reliance upon the decision of the Supreme Court in the case of *Flint v. Stone Tracy Company et al.*, 220 U. S. 107, 55 L. Ed. 389. The question involved in that case was whether or not excise taxes under the Corporation Excise Tax Act of 1909 could be levied on corporations created by the state and also whether or not a so-called public service corporation, such as the Coney Island & Brooklyn Railroad Company and the Interborough Rapid Transit Company of New York, were exempted from the operation of the statute. The Supreme Court in that case held that an excise tax could be measured by the income derived even from exempt securities and further held that the so-called public service corporations were subject to the excise tax. The statement of the Supreme Court that the supplying of water by a municipality was not a governmental function was merely dictum. The Supreme Court stated, among other things:

> "The true distinction is between the attempted taxation of those operations of the states essential to the execution of its governmental functions, and which the state can only do itself, and those activities which are of a private character."

This language, it is most respectfully submitted, is direct authority for the position taken by the A. T. Jergins Trust in the case at bar. It is recognized that state and local governments in the United States were created for the purpose of protecting the life, liberty and property of the citizens and promoting their "general welfare". The problems of protection in a modern city include not only the protection afforded by uniformed and armed police-

men but also protection against many other dangers as great if not greater than the danger of the criminal or the outlaw. The protection of life includes necessarily the protection of health, which can be secured only by the creation and maintenance of a sanitary environment. This naturally includes clean streets, clean lots, the filling of swamps and destruction of breeding places for mosquitoes, flies and other insects which carry and scatter disease germs, the construction and maintenance of safe highways for travel, the elimination of danger to travelers on account of mud holes and swampy conditions in streets. It also includes the protection of life and property by guarding against destructive fires, which can be accomplished only by the maintenance of adequate fire fighting apparatus supported by an adequate and reliable water supply. The foregoing activities are essentially the activities of a government, and when undertaken by a municipality, come clearly within the accepted and oft-repeated definition of "governmental functions".

No higher police duty rested upon the city of Long Beach than that of giving protection to its citizens against the evils existent at the time the lands were purchased. It had that duty to perform and its discretion as to how it performed that duty may not be questioned by the Federal Government.

In determining what is a governmental function or a proprietary function, we must necessarily look to the activities of the city in the light of modern tendencies. When Rome was at its zenith police protection as well as fire protection was a proprietary and not a governmental function. (See Monro Municipal Government Admin-

istration 1923, Chapter 1.) Education formerly was not a duty of a government nor was the care of public health; today courts are in agreement that these duties are governmental in character. It was not until the nineteenth century that the various states of the United States began to use municipal corporations as agencies of the state in the performance of state duties.

The Supreme Court of the state of California has consistently held that the rights of a city to water lands and river beds were essentially governmental in character. In the case of the *City of San Diego, a municipal corporation, plaintiff, v. Cuyamaca Water Company, a corporation, et al.*, 209 Cal. 105, at page 130, stated:

> "It should at the outset be understood and stated that the pueblo rights, and hence the rights of its successor, the City of San Diego, to whatever of the waters of the San Diego River were from time to time required for the needs of the pueblo and of the city and of the inhabitants of each, were rights which were essentially 'governmental' in character, as much so in fact as were the rights of the ancient pueblo and modern city to the public squares or streets, and that the term 'proprietary', as employed with reference to certain commercialized uses made by municipalities and other public bodies, of water, light and power, for example, has no application to the fundamental rights of the plaintiff herein to its ownership of its foregoing classes of property dedicated and devoted to public uses."

The case at bar is not within the purview of the Supreme Court's decisions in the cases of *South Carolina v. United States*, 199 U. S. 437, and *Salt Lake City v. Hollister*, 118 U. S. 256.

This Honorable Court's opinion in the Coronado case sufficiently answers the argument advanced by the Commissioner with respect to these cases. It is interesting to note in the South Caroline case, that this Honorable Court took great pains to state that the tax therein attempted to be collected was not a tax on property, and in this respect stated, page 458:

> "Further, it may be noticed that the tax is not imposed on any property belonging to the state, but is a charge on a business before any profits are realized therefrom.
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> * * * * * * * *
>
> "So here, the charge is not upon the property of the state, but upon the means by which that property is acquired, and before it is acquired."

There was no constitutional question raised in the case of *Salt Lake City v. Hollister,* 118 U. S. 256. The only question involved in that case was whether or not the city could be relieved of the tax merely because its activities in distilling liquor was beyond and outside of its corporate powers. The right of the United States to tax a municipality engaged in the liquor business was not presented to the court in that case. The court held that even though the act of the city in distilling the liquor was beyond its corporate powers, nevertheless, it was subject to the tax. This case, like the South Carolina case, is not applicable to the case at bar because of the fact that the tax in the case at bar amounts to direct tax on land.

The Commissioner has urged that the city with respect to its oil lease was engaged in a commercial enterprise. Even though the incidental use made of the land by the

city may be classified in part as a commercial enterprise, nevertheless, that is not sufficient to deny the immunity. The bank in the case of *McCulloch v. Maryland*, 4 Wheat. 316, was not only acting as the Federal Government's depositary but it was also engaging in a commercial enterprise in competition with other banks. This fact, although insistently urged, did not deter this Honorable Court from holding the bank exempt from tax. Of course, every activity of a sovereign involves to a more or less extent a certain amount of "business". The Federal Government in taking over and conducting its postal department, monopolized a business that had theretofore been carried on by individuals. It might some day take over the radio and the telegraph. The numerous activities of the Federal Government in its reclamation service, Panama Canal service, Alaskan Railway, et cetera, are closely related to "business" but that does not give the state permission to tax these activities.

Even though the imagination be stretched to a point where the utilization of the city's lands by the leasing thereof to taxpayer can be classified as "engaging in business", still these activities would be within the purview of the McCulloch and the Baltimore & Ohio Railroad cases. If the city of Baltimore could, in its municipal capacity, purchase stocks of a railroad company in order to attract business to the city, and be immune from tax upon the income therefrom, then certainly the city of Long Beach may develop publicly owned lands for the benefit of the city and be likewise exempt.

The city having been given the constitutional right to own land certainly ought to be the sole judge of how that

land should be utilized. This proposition has been sustained by this Honorable Court in the case of *United States v. Baltimore & Ohio Railroad Company*, 17 Wall. 322; 21 L. ed. 597, at pages 599, 600 and 601, wherein among other things, in referring to the purchase of bonds by the city of Baltimore, it was stated:

> "* * * The right of the states to administer their own affairs through their legislative, executive, and judicial departments, in their own manner through their own agencies, is conceded by the uniform decisions of this court and by the practice of the Federal government from its organization. This carries with it an exemption of those agencies and instruments, from the taxing power of the Federal government. If they may be taxed lightly, they may be taxed heavily; if justly, oppressively. * * *
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> * * * * * * * *
>
> "Was it exercised for the benefit of the municipality, that is, in the course of its municipal business or duties? In other words, was it acting in its capacity of an agent of the state, delegated to exercise certain powers for the benefit of the municipality called the city of Baltimore? Did it act as an auxiliary servant and trustee of the supreme legislative power? The legislature and the authorities of the city of Baltimore decided that the investment of $5,000,000 in aid of the construction of a railroad, which should bring to that city the unbounded harvests of the West, would be a measure for the benefit of the inhabitants of Baltimore and of the municipality. This vast business was a prize for which the states north of Maryland were contending. Should it endeavor by the expenditure of this money or this credit to bring this vast business into its own state, and make its com-

mercial metropolis great and prosperous, or should it refuse to incur hazard, allow other states to absorb this commerce, and Baltimore to fall into an inferior position? *This was a question for the decision of the city under the authority of the state. It was a question to be decided solely with reference to public and municipal interests.* The city had authority to expend its money in opening squares, in widening streets, in deepening rivers, in building common roads or railways. The state could do these things by the direct act of its legislature, or it could empower the city to do them. It could act directly or through the agency of others. *It is not a question to be here discussed, whether the action proposed would in the end result to the benefit of the city.* It might be wise, or it might prove otherwise. The city was to reap the fruits in the advanced prosperity of all its material interests, if successful. If unsuccessful, the city was to bear the load of debt and taxation, which would surely follow. The city had the power given it by the legislature to decide the question. It was within the scope of its municipal powers.

"This advance of the city bonds was not a donation. It was an investment supposed to be judiciously made and adequately secured. It was not for the individual benefit of those managing the business. No one received advantage except as he was a citizen or his property was within the city. It was not a loan for the benefit of the railroad; it was for the benefit of the city solely. That the railroad company was also benefited did not affect the purpose of the transaction.

* * * * * * * *

"The action is no less a portion of the sovereign authority, when it is done through the agency of a town or city corporation." (Italics ours.)

We believe that the Circuit Court of Appeals was right when it said [R. 185]:

> "The general purpose of the city of Baltimore in purchasing the bonds of the Baltimore & Ohio Railway Company was much less closely related to the governmental functions of the city than the acquisition by the city of Long Beach of water-bearing lands and a water-distributing system for the inhabitants thereof, and for their fire protection."

The Government has urged that the tax upon the lessee of the city's land is not a burden upon the city. This has been answered by this Honorable Court in the Gillespie and Coronado cases. It must be recognized that the lessee must derive profit in order to continue to obtain the oil for the city. The greater the tax the lessee has to pay the greater the profit it must obtain from the city and consequently the less the city would obtain. The tax on the lessee's income would naturally diminish the city's fund; "that the amount of this fund will be diminished to some extent by the requirement that the lessee pay a tax upon its income derived from the sale of its proportion of the oil is as clear in the case at bar as in those cases wherein the right of the Federal or State Government to tax proceeds from publicly owned oil lands has been denied". [Circuit Court Opinion R. 187.]

To permit an inquiry into the purposes for which funds derived by a city from the issuance of its bonds or other borrowings would cause turmoil and dismay. If the Federal Government may in the determination of its taxes inquire into the uses to which the funds of a city are devoted so may the states and cities inquire into the uses made of funds obtained by the Federal Government from

taxation, bonds, contracts, utilization of lands, et cetera. The states may also inquire into the functions performed by officers of the Federal Government, such as those officers connected with the reclamation service, the Panama toll service, Insular Barge Company, Muscle Shoals, post-office, et cetera. To allow an inquiry into the purposes for which the funds were devoted by the city of Long Beach would be "derogatory to the latter's dignity, subversive of its powers and repugnant to its paramount authority".

It is, therefore, respectfully submitted that the A. T. Jergins Trust was an instrumentality of the city of Long Beach and as such its income derived from the city's land was exempt. The A. T. Jergins Trust was not only the recipient of income from a source that is exempt (like a municipal bondholder) but its relations and activities were so intimately connected with the affairs of the city of Long Beach that if anything, the A. T. Jergins Trust stands in a much better position than the mere holder of a bond or an Indian lessee. There is more reason and logic for holding that the income received by the A. T. Jergins Trust is immune from taxation because of the supervisory power and control exercised over it by the city of Long Beach than there is for holding the income received by a municipal bondholder or an Indian lessee immune from taxation.

The Commissioner of Internal Revenue would have this Honorable Court depart from its rulings repeatedly announced during the last century. The conservation and

orderly development of our institutions necessarily rest on our acceptance of the results of the past, and their use as lights to guide our steps in the future. These fundamental principles giving vitality as they did to the Constitution and forming the very foundation of our Federal Government should, it is most respectfully submitted, be affirmed. Legal precedents may sometimes be overruled, but the constitutional principles herein presented, hedged about as they are by precedents over a century old, should, it is respectfully submitted, not be disturbed.

The Decision of the Board of Tax Appeals as to Depreciation Deductions Was Correct.

There was also submitted to the Board of Tax Appeals the question whether or not the capitalized sums for drilling cost and development expense in connection with oil wells were returnable to Respondent through a depletion or a depreciation allowance. [R. 113-115.] The Board held that they were subject only to depreciation allowance. [R. 120-123.] As the court below held that all of Respondent's income from oil wells was immune from tax, it found it unnecessary to consider or treat this question. The precise question under the identical provision of the Revenue Act of 1926 and Regulations thereunder is now before this court in *United States v. Dakota-Montana Oil Company*, No. 434, October Term, 1932 and *Petroleum Exploration, Inc. v. Burnett*, No. 448, October Term, 1932, which will be argued before this case. Taxpayer's

contentions on this question are fully set forth in the brief of Messrs. Thomas R. Dempsey and A. Calder Mackay as *amici curiae* in those cases and taxpayer adopts the argument there presented as its argument on this phase of the instant case, without burdening the Court with a repetition thereof. For reasons there stated, we believe the decision of the Board of Tax Appeals on this question was correct.

CONCLUSION.

I.

The principles taxpayer is contending for have by virtue of the oft-repeated decisions of this Court become part of the Constitution. The decision of the Circuit Court is not an extension of the immunity doctrine. It, therefore, should be affirmed.

II.

If the judgment of the Court below is affirmed, then the depreciation question becomes academic. In any event, the Board's decision on this question is correct.

Respectfully submitted,

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(See Postscript pages 39 and 40.)

Postscript—Counsel for Taxpayer have this 2nd day of February, 1933, received a typewritten copy of the Government's brief which was received after Taxpayer's brief had been sent to the printer.

Taxpayer respectfully calls the Court's attention to some apparent misconception on the part of Government counsel with respect to facts in the record. Government counsel under Division A of his argument makes the statement that it is apparent that much of the property acquired was not presently required in connection with the city's water supply. This statement is not borne out by the evidence as the record shows that the water was obtained "from subterranean sources through which wells had been bored". [R. 98.]

Government counsel further states that the land leased to the Jergins Trust was "in effect segregated from the balance of the land and not devoted to water purposes". The record shows that 600 acres of land originally acquired have ever since been used by the city for water purposes. [R. 99.] Furthermore, the record shows that the 140 acres of land leased by the city to the Jergins Trust was part of the city's "water system property". [R. 100.] A reference to the lease further shows that there were reservoirs and water equipment on the land covered by the Jergins lease. [R. 101.]

The record clearly shows that the entire 600 acres of land, including that portion thereof leased to Jergins have at all times since their acquisition been used and now are being used by the city of Long Beach for the purpose of obtaining water to carry on the city's activities. The findings of fact made by the Board and the terms of the lease refute the Government's suggestion that that portion

of the land leased to Jergins Trust was abandoned by the city for water purposes.

The reference made by Government counsel to the "Auditor's Annual Report" is unwarranted as this is not a part of the record. Counsel for Taxpayer have not had an opportunity of examining this report. It does not appear from the Government's brief whether any of the funds derived by the city from the oil and gas were devoted to the purposes shown in the Auditor's Report. It is believed that the contentions of counsel in this respect have been answered by this Court in the case of *United States v. Baltimore and Ohio Railroad Company*, 17 Wall. 322; 21 L. ed. 597.

In the Government's brief attention is directed to the case of *Marin Water Company v. Town of Sausalito*, 168 Cal. 587. It is interesting to note in this case that the Court declared that the distinction between a proprietary and a governmental function was "wholly fictitious, and apt to produce embarrassing consequences if extended and applied to other cases than those then before that court". The cases wherein a distinction has been made between a governmental function and a proprietary function are tort cases and the distinction grew up because of the necessity of giving redress to a person injured by the city. However, it is extremely interesting to note that despite this fictitious distinction the California Court refused to allow an execution to issue against the water works and water system of a municipal corporation. It is respectfully submitted that this fictitious distinction cannot be used as a criterion for the determination of the limit of interference by the Federal Government with the functions and activities of the state government.

APPENDIX.

United States Constitution—Implied Provisions.

Constitution of the state of California:

"Article XIII, Sec. 1. Taxation to be in proportion to value. All property in the state except as otherwise in this Constitution provided, not exempt under the laws of the United States, shall be taxed in proportion to its value, to be ascertained as provided by law, or as hereinafter provided. * * *; and further provided, that property used for free public libraries and free museums, growing crops, property used exclusively for public schools, and such as may belong to the United States, this state, or to any county, city and county, or municipal corporation within this state shall be exempt from taxation, * * *."

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

"Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

Section 213 of the Revenue Act of 1924, c. 234, 43 Stat. 253, 267, 283 (U. S. C., Title 26, Secs. 954 and 985) contain provisions substantially the same as those of the corresponding section of the 1921 Act above quoted.